No. 12,828

IN THE

United States Court of Appeals

For the Ninth Circuit

ALICE McCOURT LAMM,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

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PETITIONER'S REPLY BRIEF.

The statement of facts in the respondent's brief generally follows the Stipulation, except in one significant particular. Like the Tax Court's findings of fact, the brief copies most, but not all, of the sentences at the beginning of paragraph 8 of the Stipulation of Facts (R. 27). The Tax Court copied only so much (R. 140):

> "In accordance with the Instructions and Agreement, Trust Company duly remitted collections of interest and principal paid to it by Lamm Lumber Company to those owners shown to be entitled thereto."

The respondent's brief added:

> "in accordance with their [sic] ownership interests."

The significant words, however, were omitted by both:

> "* * * Trust Company duly remitted collections of interest and principal * * * to those owners shown to

> be entitled thereto in accordance with *the* ownership interests *set forth in said Exhibit 3-C''* (R. 27),

—i.e., the list kept by the Trust Company as a master record of ownerships governing the payments, as made from time to time, of principal and interest on the notes. Why these stipulated words were omitted in both the Tax Court's and the respondent's statement of facts we cannot guess, but it is obvious that these words, together with the uncontradicted testimony (R. 126), expresses the essential fact of the case, clearly establishing that the Trust Company and all other parties considered, treated, and acted upon the list as a controlling register of the owners of the notes and the extent of their ownership interests.

The Government's brief makes no serious effort to support the ground of the Tax Court's decision, namely, the theory that corporate notes must be placed in registered form *by the debtor corporation* in order to come within section 117(f) of the Internal Revenue Code. That ground our opening brief showed to be erroneous (Petnr.Op.Br. pp. 24-26), and the Government has apparently abandoned it. Respondent's only comment on this contention (Br. for Resp. pp. 17-18) is to refer to a supposed ''ordinary meaning'' of the term ''in registered form'' as being that the evidence of indebtedness ''can be transferred only by an entry on the books of the debtor corporation.'' While this doubtless is the form of some registry transactions, others very commonly take the form in which a bank or trust company acts as the registrar and keeps the register, and the debtor corporation's books show only the amount of the outstanding issue or obligation (as here)—(see authorities cited in the Opening Brief, p. 13).

In place of the Tax Court's theory, the Government now contends that the notes were not in registered form because "they do not have on their face a notice to the holder that they might be registered, and that they do not have on either face or back the name of the registered owner. Therefore they are not in registered form" (Br. for Resp. p. 7).

In plain language, respondent's contention is that to be "in registered form," the notes *must* have written on them either (a) a statement that they *might* be registered, or (b) the name of the registered owner—though admitting that no case so holds (Br. for Resp. p. 7). Nor, we submit, does the statute so hold. The statute says "in *registered* form," not "in *registrable* form," as respondent's first alternative would suggest. The point of the statute is that the instrument must be *registered in fact*, not merely declaratively registrable.

Nor is there any requirement that the name of the registered owner appear on the instrument—and in this case in particular such an attempt would be a useless complexity if ever there was one. There were thirteen notes, and nineteen separate investor interests, including several joint tenancies and fiduciary relationships (R. 139-140). The notes themselves were endorsed and delivered to the Trust Company, with the list of ownerships. To have inscribed this entire roster of owners, with their proportionate interests, on each of the notes *when the notes themselves were held by the Trust Company* would serve no purpose whatever. The Trust Company kept the list and made its payments in strict accordance with it; and those facts served every possible purpose of registration. To argue that, in addition, the whole list had to be written

upon every note is, we submit, to go to the extreme in urging an idle act.

Respondent argues, however, that some such notation on the face of the instrument is essential in order to protect the holder, which is the purpose of registration (Br. for Resp. pp. 12-13)—citing *Gerard v. Helvering* (2 Cir. 1941) 120 F.2d 235, and going on to argue that a bona fide purchaser from a thief of the notes would be able to recover from the maker because of the absence of such notation here. Respondent's whole emphasis in this discussion is upon the supposed requirement of the notice to possible transferees, so as to protect the holder. As above mentioned and as further shown below, there was no such necessity here because the notes were in the hands of the registrar itself. The dictum in the *Gerard* case, which apparently dealt with the type of corporate bonds which otherwise can be passed from hand to hand, has no bearing upon the very different situation which exists here. The applicable rule and authority, which respondent ignores in its brief, is that of the Tax Court in *Matilda S. Puelicher* (1946) 6 T.C. 300, 303, quoted in our opening brief (p. 16) which shows that the basic requirement is the listing of ownerships in a register maintained for that purpose, and impairment of negotiability to the extent of requiring a change in the registration to indicate the change of ownership.

In this connection, it may be noted that respondent is wrong in suggesting (Br. for Resp. p. 13) that in the absence of notation upon the notes themselves, a bona fide purchaser would be able to recover from the maker if the notes had been stolen (citing no authority). The

notes were indorsed to the Trust Company, "and the indorsement of such indorsee is necessary to the further negotiation of the instrument."

> Uniform Negotiable Instruments Act,[1] sec. 34;
> Cal. Civ. Code, sec. 3115.

Thus, in order to negotiate the notes, if stolen, it would be necessary to forge the Trust Company's indorsement, and

> "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, *or to enforce payment thereof against any party thereto, can be acquired through or under such signature,* unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority" (emphasis added).

> Uniform Negotiable Instruments Act, sec. 23;
> Cal. Civ. Code, sec. 3104.[2]

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[1]This Act is in force in all 48 states, Alaska, Hawaii, Puerto Rico, and the District of Columbia.

[2]To the same effect are:

Austell Bank v. National Bondholders Corp. (1939) 188 Ga. 757, 4 S.E.2d 913, 914;

Fourth Nat. Bank v. Lattimore (1929) 168 Ga. 547, 148 S.E. 396, 398;

Hayes v. Midland Credit Co. (1928) 173 Minn. 554, 218 N.W. 106;

Oil State Refining Co. v. Bryant (1925) 110 Okl. 83, 236 Pac. 431, 434;

Borserine v. Maryland Casualty Co. (8 Cir. 1940) 112 F.2d 409, 415;

National Metropolitan Bank v. Realty Appraisal & Title Co. (App.D.C. 1931) 47 F.2d 982, 984;

Security-First Nat. Bk. v. Bk. of America (1943) 22 Cal.2d 154, 157, 137 P.2d 452;

Anglo-California Trust Co. v. French American Bk. (1930) 108 Cal.App. 354, 357, 291 Pac. 621.

In this case any notation on the notes showing that they were registered would have been superfluous, since the owners did not have possession of the notes and therefore could not negotiate them without the Trust Company's knowledge. Furthermore, as the notes were overdue they were no longer negotiable, so that they could not fall into the hands of a holder in due course, and the equities of the owners could not be lost.[3]

Respondent's efforts to answer the opening brief center in two contentions: That the Trust Company was the mere collecting agent for the taxpayers and not the agent of the Lumber Company (Br. for Resp. pp. 16-17), and

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[3]Although eleven of the notes were payable on demand, the latest of the eleven was issued on September 5, 1934.

> "Where an instrument payable on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course."
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> Uniform Negotiable Instruments Act, sec. 53;
> Cal. Civ. Code, sec. 3134.

In *McAdam v. Grand Forks Mercantile Co.* (1913) 24 N.D. 645, 140 N.W. 725, the court said (p. 727):

> "There is no question that the note under consideration was past due, both when purchased by Vallely and when purchased by the plaintiff. It was a demand note, dated January 16, 1904. It was purchased by the plaintiff on March 6, 1905. It is well established that a note payable on demand is due within a reasonable time after its date, and there are practically no authorities which hold that such reasonable time can be extended beyond a year."

Accord:

State & City Bank & Trust Co. v. Hedrick (1930) 198 N.C. 374, 151 S.E. 723 (nearly six months elapsed between issuance and last negotiation; transferee held not a holder in due course);

Grossman v. Chechila (1926) 127 Misc. 151, 215 N.Y.S. 353 (one year);

Schmoldt v. Chicago Stone Setting Co. (1941) 309 Ill.App. 377, 33 N.E.2d 182, 184 (sixteen months);

Franklin v. St. Louis Car Co. (1928) 321 Mo. 199, 9 S.W.2d 901 (eighteen months);

Title Loan & Investment Co. v. Fuller (1919) 105 Kan. 395, 184 Pac. 727 (twenty months).

that the taxpayers did not purchase the notes on a long-term investment basis because the notes were demand notes or already overdue (Br. for Resp. p. 18).

Respondent's argument concerning the agency situation makes three points: The Instructions and Agreement (R. 55-62) expressly constituted the Trust Company as the agent of the taxpayers for certain specified duties; the Lumber Company was not a party to this agreement; the Lumber Company merely "offered to contribute" $250 a year for the Trust Company's services and made a "friendly suggestion" concerning the computation of interest. None of these points, we submit, has merit.

The Trust Company was in fact the agent for *both* the Lumber Company and the purchasers of the notes. There is nothing unusual in such a double agency. Agency for two principals is always permitted where, as here, both principals have knowledge of the facts and their interests are not conflicting, and the agent does not have to exercise his judgment in favor of one against the other (3 C.J.S. 18).[4]

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[4]A common situation where the same agent represents each or both parties to a transaction is the familiar escrow arrangement.

Greenzweight v. Title Guar. & Tr. Co. (1934) 1 Cal.2d 577, 582, 36 P.2d 186;

Shreeves v. Pearson (1924) 194 Cal. 699, 707, 230 Pac. 448.

Other examples of an agent representing both principals in a transaction are where an agent for an insurance company also represents the insured,

John Conlon Coal Co. v. Westchester Fire Ins. Co. (N.D. Pa. 1936) 16 F.Supp. 93, 95, affd. 92 F.2d 160, cert. den. 302 U.S. 751;

Rossi v. Firemen's Ins. Co. (1932) 310 Pa. 242, 165 Atl. 16, 18,

and where an agent represents both vendor and purchaser of land:

United States v. Grace Evangelical Church (7 Cir. 1942) 132 F.2d 460, 462;

Allen v. Dailey (1928) 92 Cal.App. 308, 313-314, 268 Pac. 404.

To argue, as respondent does, that the Lumber Company was not a formal party to the Instructions and Agreement which the taxpayers signed is to ignore the essential nature of the transaction as an entirety. The transaction as a whole went far beyond the Instructions and Agreement. The record plainly shows that the Lumber Company was fully aware of the purchase of the notes by the taxpayers ("Relative to our R.R. mortgage which you hold in trust for the new owners"—R. 64); that the Lumber Company agreed to accept the Trust Company as the one to whom payments should be made in discharge of its obligation to the note owners, and to accept and make part payment for the services of the Trust Company in paying over the proceeds to the purchasers and real owners of the notes; and that the Lumber Company arranged with the Trust Company as to the computation of interest on the diminishing balance (which, of course, affected not only the amounts credited, respectively, to interest and principal on the Lumber Company's obligation, but also determined the amounts to be paid over as principal and interest to whoever might be the proportionate owners of the notes from time to time).

Respondent misstates the arrangement regarding payment for the Trust Company's services as a mere "offer to contribute" on the part of the Lumber Company. The Lumber Company gave a polite but positive direction: "Our company should therefore pay the same in the future and the participants in ownership should pay the

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In *Schiltz v. Wokal* (1942) 154 Kan. 677, 121 P.2d 240, 242, a bank acted as agent for plaintiff in collecting a note issued by defendant. The same bank acted as agent for the defendant in making payments on the note from collections from another note owned by defendant and secured by part of the land securing the first note.

balance. * * * Please bill us" (R. 64-65). These words carry the intention, tenor and form of a mandatory direction as to the framework which one phase of the transaction should take. The arrangement was "voluntary" (Br. for Resp. p. 17) only in the sense that the making of any binding contract is voluntary; when completed, it becomes obligatory. The Tax Court found (R. 141) that by this letter the Lumber Company *agreed* to pay a share of the total charges. The letter cannot be passed off as a "friendly suggestion" simply because it is worded in a polite manner and requests the Trust Company's confirmation. The parties acted upon it; again we call attention to the stipulated facts that

> "Trust Company's charges for its services in collecting and remitting interest and principal payments *and in maintaining a record of ownership were shared* by the participating owners of record and *by Lamm Lumber Company* * * *" (emphasis added) (Stipulation of Facts, par. 9; R. 27).

Respondent's final argument that the fact that the notes were either demand notes or already past due when purchased and therefore "could have been paid immediately" "does not tend to show a long-term investment" (Br. for Resp. p. 18) needs but brief mention. On the contrary, every incident of the transaction shows that it was a long-term investment affair. The notes were long past due, and the demand notes had to be issued to cover unpaid interest because the Lumber Company had long been in serious financial difficulties and could not pay even the interest. Southern Pacific Land Company, the holder of the notes, sold them to the taxpayers at one half the amount of the obligation (R. 63-64). It is unrealistic to assume that this would have been done if there had been

any likelihood that the notes could have been paid immediately or within the six months' period of a short-term capital investment. Furthermore, the arrangement with the Trust Company, with its attendant details and expense, unquestionably signified an investment to be held and realized over a considerable period of time.

The respondent's whole approach to this problem is based upon hypothetical assumptions as to the nature of the transaction contrary to the actualities of the situation. It is stipulated that the taxpayers purchased the notes for investment. Because the obligor gradually became solvent, the taxpayers' investment appreciated in value. This is the essence of a capital gain, which it is the design of the law to tax only as to one half of its amount (or to credit only as to one half of its amount had there been a loss). So far as regards the formalities of the law, it is not concerned with how or when or by whom the securities are registered so long as they are in fact registered at the time of their retirement. Here the list of ownerships kept by the Trust Company (which had possession of the notes and needed no other protection) served every purpose of a register and was treated and acted upon as such.

Dated, San Francisco, California,
May 31, 1951.

Respectfully submitted,
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